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TAGS: [EFIN](#) [ECON](#) [ETRD](#) [PREL](#) [AR](#)
SUBJECT: ARGENTINE CENTRAL BANK PRESIDENT PROPOSES REGIONAL
COORDINATION OF MONETARY POLICIES IN MEETING WITH FED
GOVERNOR KROSZNER

REF: A. BUENOS AIRES 1270
[B](#). BUENOS AIRES 1263
[C](#). BUENOS AIRES 1236
[D](#). BUENOS AIRES 1224

Classified By: Ambassador E.A. Wayne for Reasons 1.4 (b,d)

Summary

[1](#). (C) U.S. Federal Reserve Bank Governor Randall Kroszner pointed to signs that slowing growth and higher inflation in advanced economies are beginning to impact emerging markets during his keynote speech at the Argentine Central Bank's (BCRA) annual monetary and banking conference. He argued that the popular idea that the U.S. and world economies have "decoupled" is incorrect. Other conference participants presented similar themes, with the general consensus that current global economic difficulties have a ways to go. In a side meeting, BCRA President Martin Redrado asked for Kroszner's support for greater central bank coordination in the region -- using an expanded version of the NAFTA framework -- in order to improve monetary authorities' responses to global challenges. On Argentina's economy, Redrado noted his worry about high inflation and lack of investment, but claimed the BCRA's monetary policy was appropriate and pointed to positive signs that the GoA is tightening fiscal policy. (Separate meetings with economists, industrialists, and bankers reported Ref A.) End Summary.

Kroszner: Decoupling Theory Incorrect

[2](#). (SBU) Federal Reserve Bank Governor Kroszner visited Argentina September 1-2 at the invitation of BCRA President Martin Redrado, in order to speak at the BCRA's annual monetary and banking conference. The conference, titled "Financial Turbulence: Impact on Developed and Emerging Economies," featured central bankers, economists, and private bankers from around the world. Kroszner gave a keynote presentation, early on September 1, entitled, "The United States in the International Financial System: A Separate Reality? Resolving Two Puzzles in the International Accounts."

[3](#). (SBU) In his speech, Governor Kroszner argued that the idea that the U.S. and world economies have "decoupled" has been proven incorrect. Due to close trade and financial

linkages, "concerns about potential spillovers from slower U.S. growth and weaknesses in the financial system" are weighing on advanced economies, and there are growing indications of reduced growth prospects and higher inflation in many emerging market economies. He also argued for reducing trade barriers to agricultural products to allow global food suppliers to adjust more efficiently and rapidly to price signals to meet growing world demand.

¶4. (SBU) Most other presenters at the BCRA conference supported Kroszner's argument that emerging markets will soon feel the effects of the broad slowdown in developing economies. Another common theme was that while the U.S. economy had showed resilience due to strong export growth, this effect would likely diminish during the second half of 2008, as the economies of its major trading partners continued to deteriorate -- particularly those in Europe. The broad consensus among speakers was that the global economic downturn -- characterized by financial turmoil and uncertainty, decelerating growth, and higher inflation -- is still developing and has a ways to go.

¶5. (C) Kroszner's visit coincided with Argentine President Cristina Fernandez de Kirchner's (CFK) surprise September 2 announcement that the GoA would pay off all Paris Club debt using BCRA reserves (see Refs B, C, D, for readout on that decision and local and international reaction). The announcement eclipsed the BCRA's conference in local and foreign media, and became a central theme of Governor Kroszner's subsequent meetings. During Kroszner's September 1 meeting with BCRA President Redrado, the Ambassador mentioned that he understood that Cabinet Chief Sergio Massa

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was interested in Paris Club repayment. However, this did not elicit any reaction from the Central Bank Chief, and Redrado also gave absolutely no indication that he was aware that the next morning the President would publicly instruct her Economy Minister to use BCRA reserves to pay Paris Club members. (Comment: Post's BCRA contacts confirm media reports that Redrado found out about the decision at most hours before CFK's 11:30 a.m. speech.)

BCRA's Redrado Raises Concerns, Highlights Positives

¶6. (C) During Governor Kroszner and Ambassador Wayne's evening meeting with BCRA President Redrado on September 1, Redrado lobbied Governor Kroszner on the idea of expanding the NAFTA Central Bank coordinating mechanism to include the central banks of major South American countries (specifically Argentina, Brazil, Chile). He said he had mentioned this idea to Mexican Central Bank Governor Guillermo Ortiz during the recent meeting of the Bank for International Settlements' consultative group for the Americas, and said Ortiz supported the idea.

¶7. (C) Redrado argued that expanding the existing NAFTA mechanism would improve coordination of regional monetary policies and enable the region's monetary authorities to respond more effectively to global and local economic challenges. He also noted that it would help improve the quality of the current analytical framework in the South American Central Banks. While acknowledging that some of this was occurring through the Centre for Latin American Monetary Studies (CEMLA), he urged Kroszner to consider the idea. Governor Kroszner agreed to consult on the suggestion within the Fed upon his return to Washington.

¶8. (C) Turning to the Argentine economy, Redrado claimed that the crisis generated by spiking inflation and the four-month (March - July) agricultural conflict had given the BCRA an opportunity to reduce peso liquidity in the market by selling dollars. This had resulted in a stronger currency. With capacity utilization high, he argued that peso depreciation

now would just result in higher inflation rather than enhancing domestic industry's ability to compete globally. He joked that GoA officials obviously had not learned from history books the folly of taxing farmers, and the resulting farm crisis had recalled memories of the 2001 financial meltdown. Redrado informed Kroszner and the Ambassador that 8% of deposits flowed out of the financial system in May, as Argentines sought safety in dollars. Redrado claimed that the BCRA's intervention stemmed this outflow ("the buck literally stopped here"). Redrado argued that this panicky response to local economic uncertainty showed, once again, that Argentina is not ready for a floating exchange rate regime.

¶9. (C) The BCRA reacted to the crisis by selling 3.5 billion in dollars, extracting 10.5 billion pesos from the market. As a result, Redrado claimed, money growth had slowed recently, with public and private M2 (cash in circulation plus checking and savings accounts) now growing at a 14% annual pace, and private M2 recently increasing at only about a 13% y-o-y pace (compared to private M2's 28% increase in 2007 and the year-to-date average M2 increase of 22%). Nevertheless, Redrado pointed out that he has said consistently since 2006 that GoA fiscal policy is inconsistent with the BCRA's gradual efforts to tighten monetary aggregates to limit price inflation. Although interest rates are significantly higher now, and the peso stronger ("not an anti-inflation tool, but it helps"), Redrado commented that this can not fully counteract the effects of the 50% nominal growth in GoA expenditures in 2007.

¶10. (C) Fortunately, he noted, there are signs in the last month that the GoA is more aware of the need to tackle inflation. He highlighted two positive signals: 1) while the GoA helped negotiate 22-23% salary increases in March, the President has since forcefully opposed calls for further wage hikes; and 2) fiscal policy has tightened in the last few months, with expenditures now growing at a 30% y-o-y pace. (Note: well-known Argentine economist Miguel Bein argues that if the GoA maintains this relative fiscal tightening it could

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end the year with a primary fiscal surplus of 3.7% -- significantly higher than the GoA's 3.15% estimate for the primary surplus that was included in the 2008 budget.)

¶11. (C) One of the most damaging results of high inflation, in his opinion, is its adverse impact on investment -- crucial to expanding capacity and maintaining the expansion (now in its six year). He noted that businesses were responding to the high inflation rate by maintaining incredibly short-term business planning horizons of six-months or less, and were focused on self-preservation (cutting back investment and protecting their balance sheets). The result has been anemic domestic investment that is nowhere near needed levels.

¶12. (C) Redrado emphasized that the importance of the BCRA's ongoing seminar was to show that high inflation and decelerating growth are currently common problems around the world. This was his attempt to convince GoA officials (specifically the Kirchners) that they can accept these trends without having to acknowledge them as the results of their policy failures. He saw this acceptance as the first step towards convincing the Kirchners to make policy adjustments. Kroszner agreed, commenting that contraction in U.S. and Europe is affecting China, India, and most other emerging economies, and it is important to get the message out that it is not necessarily the fault of governments when their economies sour or of Central Banks when they are forced to make unpopular decisions. Unfortunately, Redrado lamented, Argentine public discussion of these issues generally ignored global forces, making the BCRA a lightning rod for criticism.

¶13. (U) FRB Governor Randall Kroszner did not clear this
cable.
WAYNE